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SUBJECT: POLITICS AND POPULISM DRIVE GOVERNMENT DECISION TO PURCHASE OIL REFINERY

Classified By: Roland W. Bullen for reasons 1.4 b and d.

¶1. (C) Summary. Facing growing public displeasure with the rise in international fuel prices, President Fernandez announced on November 15 that the government intends to purchase the country's sole oil refinery from Shell Oil in order to increase the country's imports of oil under the PetroCaribe agreement with Venezuela. The announcement has galvanized populist political sentiment and received widespread support. To effect the purchase, however, the government is waging a media campaign to pressure Shell to reduce the sale price of USD 183 million it negotiated via international tender with a private consortium of companies. Government officials have alleged that the government should only pay the "real value" of the refinery and not the winning bid amount. Shell, meanwhile, maintains that the Dominican government merely has the right to first refusal and that it will not negotiate the value of its shares with the government. Although the decision was announced as a solution to the country's failure to import the maximum amount of oil under the PetroCaribe agreement with Venezuela, multiple local private sector anaylsts believe that Venezuela's production capacity problems mean it is unable to supply the maximum amount. The government purchase of the refinery raises serious concerns about the politicization of energy prices by the government in the lead up to presidential elections in May 2008. End Summary.

¶2. (SBU) In a November 15 speech that was anticipated only for its expectedly mundane listing of energy conservation projects the government is launching to deal with rising fuel prices, President Fernandez dropped a media bombshell when he led his speech with the announcement that the government has decided to purchase Shell Oil's 50 percent stake in the country's sole oil refinery, known as Refidomsa. In the nearly two weeks since the announcement, the media has swarmed on the story, largely ignoring the other initiatives listed in the speech, such as improving traffic lights and broad references to developing renewable energies. In making this announcement, President Fernandez told the country that Refidomsa's private owners' commercial interests (i.e., Shell's interests) are not in harmony with the country's national interests, and suggested that under national ownership Refidomsa would be able to avail itself of the full amount of promised subsidized oil from Venezuela under the PetroCaribe agreement. Fernandez went so far as to say that Hugo Chavez's generous solidarity with the Dominican Republic has been the only initiative that has helped the country mitigate rising fuel prices.

¶3. (U) In August of 2006, Shell Oil Company announced its intention to sell its 50 percent stake in Refidomsa following nearly 35 years as a joint shareholder with the Dominican government, which already owns the other 50 percent. The decision to sell its shares was made as part of a broader

regional corporate strategy to divest of its downstream businesses in the Caribbean. Shell explained the process according to its shareholder agreement that it would issue an international tender to the private sector and present the winning bidder, along with a purchase agreement, to the Dominican government. Shell completed its tender and presented the winning bid, worth USD 183 million, to the government on October 16. The Dominican government was given 60 days to accept the sales purchase agreement as drawn up with the winning bidder or exercise its right of first refusal and buy the refinery outright by matching the winning offer. Since Fernandez's announcement, the Dominican government, led by Finance Minister Vicente Bengoa, has waged a media campaign related to its avowed incredulity at the sale price and arguing that they will purchase the refinery but only for its "real value".

Government Rationale for the Purchase
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¶4. (C) The President of Refidomsa, Ruben Montas, who is also the brother of the Minister of Economy, Planning and Development, met with EconOff to explain the government's rationale for purchasing the refinery as well as some of the options available to the government as the sole owner. In explaining the decision, Montas said explicitly that the government was concerned both that the refinery was losing market share to private importers and that the winning bidder (a consortium of companies that includes local investors from Coastal Dominicana, which owns the country's only alternative import source for diesel, jet fuel and liquid propane gas (LPG), and international investors led by Trafigura, the somewhat notorious international fuel shipping company with a spotty safety record) would have a "monopoly" over the importation of fuel in the country. Second, he argued that a

private partner would likely import fuel from its own sources rather than under PetroCaribe, which is the government's stated intention (i.e., Trafigura/Coastal Dominicana would import fuel from Trafigura's distribution points as opposed to PetroCaribe).

¶5. (C) Finally, Montas said that 100 percent ownership would allow the company to make investments and promote priorities not consistent with Shell or any other private business's commercial interests. He confirmed that the government was considering a range of options for when they become the sole shareholder. First, he suggested that Refidomsa could begin expending a portion of its earnings on oil exploration activities, both terrestrial and off-shore. Second, he said they would invest in new storage facilities, particularly for LPG, to compete with the growth of private sector imports of LPG. Third, he said the refinery would be in a better position to begin some spending on social projects, particularly in the Haina area, which is home to the refinery and has been listed as one of the 20 most polluted communities in the world. As to how the government might finance the deal, Montas suggested that the purchase could be done through a direct loan to the refinery and amortized over a roughly five year period, financed entirely by the company's profits. This would avoid the need to dip into the government's annual budget.

Playing Politics with Oil

¶6. (C) Ambassador Pla Gomez from the Ministry of Foreign Affairs and advisor to the President of the National Energy Commission confided to EconOff that the decision to announce the purchase of the refinery was "pure populist politics". According to Gomez, lacking any other concrete or near-term means of convincing the public that the government will be able to mitigate the impact of rising fuel prices on average Dominican consumers, President Fernandez made the widely popular decision to announce the purchase of the refinery and made it the centerpiece of his energy efficiency speech on November 15.

¶7. (C) Indeed, television and radio pundits have been extremely supportive of this move, which is painted in the light of pushing out the supposedly "exploitive" international oil company, to use one pundit's words, to ensure decision making at the refinery is done in the best interest of the country. This, of course, depends on who is defining the "best interest". With the refinery completely in the government's hands, it will be difficult to resist the temptation not to exploit its power over setting national fuel prices for short-term political gain at the expense of the commercial and financial health of the refinery.

¶8. (C) The Minister of Finance, Vicente Bengoa, who has been charged with negotiating the sale with Shell, gave a press conference on November 27 concerning the government's plans to purchase the refinery. He led with a statement, which made front page news, that the government would seek independent counsel, likely through an international tender, on a valuation of the refinery. Again playing to popular sentiment, he said it is in the national interest to purchase the refinery at the "real price", implying that they believe the winning bid overvalued Shell's shares. Bengoa explicitly cited one independent observer's estimate that the refinery is worth only USD 110 million, not USD 183 million sale price.

¶9. (C) Rafael Maradiaga, the Chairman of Shell for the Dominican Republic, Haiti, Puerto Rico and Central America, told EconOff this statement completely ignores its contractual obligations and the meaning of the right of first refusal. Maradiaga lamented the fact that Bengoa, along with Aristedes Fernandez Zucco, President of the National Energy Commission and a former government appointed president of Refidomsa, have used the media to negotiate with Shell, but insisted that Shell will not engage in negotiations through the media. Maradiaga informed EconOff that Shell has agreed to have its technical advisors and legal team sit down on December 3 with the Dominican government to explain their interpretation of the shareholder agreement, including the meaning of the right of first refusal, but denied that they were "negotiating" on the price of the refinery.

¶10. (C) Obviously frustrated with the political posturing of the government's officials, Maradiaga hypothesized to EconOff, based on his conversations with government insiders, that the Fernandez Administration is hoping to delay the negotiations with Shell until March 2008 when an announcement of a concluded agreement to purchase the refinery would be

the most opportune in the lead up to May presidential elections. Maradiaga mused that this would also be an opportune time for a state-owned company to manipulate fuel prices immediately prior to elections, seconding the fear that a state-owned facility is more susceptible to politicization.

¶11. (C) ExxonMobile's local representative, Miguel Estepan, said he is also very concerned about the government owning the refinery outright, saying that the institution would have to be run as a business to ensure reliable, quality supply remains available in the country. Estepan elaborated a very similar political agenda behind the decision as hypothesized by Maradiaga. He also told EconOff that if the Dominican government pressures Shell to sell its shares in the refinery at below the offering price in its international tender bid, Shell is likely to challenge the Dominican government's position through international arbitration. Maradiaga would only say that if the government continues on the course it has laid out in the newspapers of seeking a reduction in the price, the company's executives in Europe would have to decide what course to take. But he warned that Shell could not afford to be bullied.

PetroCaribe

¶12. (C) As President Fernandez stated in his speech, and as Montas confirmed to EconOff, a prime rationale for the

decision to purchase the refinery is to increase its purchases under the PetroCaribe agreement with Venezuela. The Dominican Republic currently imports roughly 25,000 to 35,000 bbls/day of crude and refined petroleum products under PetroCaribe. However, the agreement established a ceiling of 50,000 bbls/day, which has never been met. In repeated public statements, the Dominican government has emphasized its intention to import the maximum amount under the agreement immediately. But is this even possible?

¶13. (C) Country representatives for Shell Oil, ExxonMobile, and Sargeant Petroleum all expressed skepticism to EconOff that PetroCaribe has the capacity to provide the Dominican Republic with 50,000 bbls/day. ExxonMobile described the prospect as "highly doubtful" and Shell's representative, Maradiaga, told EconOff in strict confidence that he had seen documentary evidence of the inability of PetroCaribe to provide more than about 25,000 bbls/day to the Dominican Republic. Sargeant Petroleum's Mustafa Abu Naba'a, who was also one of the non-winning bidders for the refinery, said he estimates PetroCaribe's capacity in the short-to-medium term as only about 21,000 to 25,000 bbls/day as a result of production problems at PDVSA. Abu Naba'a also told EconOff that the best way to expose the weakness of PetroCaribe is for governments to attempt to fully implement it - forcing Venezuela and PDVSA to admit their inability to supply the agreed upon amount.

¶14. (C) Ambassador Gomez, who attended the most recent PetroCaribe meeting in Caracas, said that President Chavez has used the occasion to emphasize the importance of national ownership of refining capacity and discussed his government's support for refinery projects in the region. Gomez said he wouldn't be surprised if Chavez had offered to at least partially finance the purchase of the refinery. Abu Naba'a, however, doesn't believe there is any Venezuelan involvement. In response to rumors, Venezuelan Ambassador Landis denied in the press that Venezuela is involved in financing the purchase of the refinery. Abu Naba'a did say that he is working with Libyan partners on a plan to build a second refinery in the north of the country.

¶15. (C) Comment: The Fernandez Administration's announcement clearly played to populist sentiment to score political points as the race for the presidency heats up. The decision has, in fact, had a patriotically galvanizing effect on media pundits across the political spectrum. The main concern with a wholly government owned refinery, however, is the prospect of politicizing energy decisions for short-term social or political gain justified under the banner of defending the "national interest". In addition, the purchase would jeopardize the government's ability to act as an independent regulator, which is responsible for setting weekly fuel prices, if it were also the country's prime oil importer. Based on Montas' statements alone, the government is obviously already considering ways to use the refinery's profits for social or economic projects with little or no relationship to the reliable, safe and commercially viable operation of the refinery.

¶16. (C) The approach of the Fernandez Administration to its negotiations with Shell is not helpful to the country's investment climate and should serve as a warning to U.S. firms considering investing in the country that the government often has a very flexible definition of its contractual obligations when not aligned with political expediency. Although couched as a means of augmenting the country's purchases under the PetroCaribe agreement, if the near unanimous local analysis of private energy companies is correct, there is unlikely to be any increase in PetroCaribe imports. End Comment.
BULLEN